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C O N F I D E N T I A L SECTION 01 OF 02 VILNIUS 000144

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TAGS: [AFIN](#) [ECON](#) [EFIN](#) [LH](#) [PGOV](#) [PREL](#)

SUBJECT: LITHUANIA'S FINANCE MINISTER OUTLINES GOL ECONOMIC PLAN, OFFERS ASSISTANCE ON BILATERAL ISSUES

REF: A. A. VILNIUS 138 AND PREVIOUS

[1](#)B. B. 2004 VILNIUS 760

Classified By: GSO MATTHEW SINGER
FOR REASONS 1.4 (B) AND (D)

[1](#)1. (SBU) Summary. Finance Minister Algirdas Butkevicius, meeting with Ambassador Mull on February 9, delivered an optimistic prognosis for Lithuania's continued strong economic growth. While stressing that some politically difficult questions still lie ahead, Butkevicius discussed several areas of the economy on which he is focused and expressed confidence in Lithuania's continued economic success. Butkevicius is using the target of Euro convergence in 2007 to keep Lithuania's deficits and fiscal policy in line. He discussed his hopes for adjusting Lithuania's tax code to provide more incentives for growth and to discourage the shadow economy. Butkevicius discussed prospects for Lithuania's continued economic growth and pointed to Lithuania's recent Euro bond issuance as an example of strong investor confidence in Lithuania's economy. Minister Butkevicius pledged support on a variety of tax questions that affect GOL-USG relations END SUMMARY.

[1](#)2. (C) Ambassador Mull met with Algirdas Butkevicius, recently reconfirmed as Finance Minister, February 9 as part of his tour of Lithuania's new Cabinet (ref a). It was the Ambassador's eleventh cabinet-level meeting in the last seven weeks. Butkevicius had previously expressed concern about the then-rising profile and strength of the Labor Party (ref b), which is now part of the ruling coalition. He observed that the current government is experiencing a "trial period" and is under pressure from the press. He is, nonetheless, optimistic that Lithuania's social and economic position will continue to improve. Butkevicius said that he believes that 2006 will be the most difficult year for Lithuania, because the Government will have to increase revenues in order to meet criteria for entering the Eurozone in 2007. He agreed with the Ambassador's comment that revenue-raising mechanisms -- i.e., increasing taxes and decreasing expenditures -- are not popular with parliamentarians.

Euro Convergence and Eurobonds

[1](#)3. (SBU) Ambassador Mull asked for Butkevicius' views of the recent Article IV evaluation of Lithuania by the IMF, which gave the country high marks, but raised concerns about the savings rate, productivity, and fiscal policy. Butkevicius said that the key to further reform was the GOL's euro convergence program. Butkevicius said that meeting euro convergence criteria by the GOL's target of 2007 would address the IMF's principal concerns, particularly in controlling Lithuania's deficit spending. He said that Prime Minister Brazauskas fully supports this goal and, with respect to some of the austerity measure Butkevicius described to him, told the MinFin "we have to approve the convergence program, and we have to follow it." Butkevicius also said that Lithuanian politicians seem increasingly interested in the convergence program, and that Butkevicius always explains that there are more advantages than disadvantages to the program.

[1](#)4. (SBU) Butkevicius spoke proudly of Lithuania's 600-million euro Eurobond issue that came out this month. Demand for the issue exceeded 4 billion euros. He also highlighted the bonds record-low yield 3.75 percent, as opposed to the Eurobond issue in 2004, which yielded 4.5 percent. Butkevicius feels that this decrease in the cost of borrowing reflects international market confidence in Lithuania's economic stability and prospects.

Adjusting Lithuania's Tax System

[1](#)5. (SBU) When questioned by Ambassador Mull as to whether he approved the use of tax incentives to increase foreign direct investment (FDI) in Lithuania, Butkevicius noted that overall FDI increased in Lithuania last year. He also noted that Lithuania's tax burden relative to GDP is the lowest in Europe. Butkevicius acknowledged, however, that the tax structure for Lithuania's capital and labor markets is

unbalanced: for labor, taxes are too high, and for capital they are too low. Butkevicius said that he would like to incrementally lower the personal income tax (PIT) in Lithuania. Currently, the tax stands at 33%. The Minister would like to reduce it to 30% in 2006, 27% in 2007, and 24% in 2008. Butkevicius also said that he is in discussions amending the law on profits to recognize training costs as business expenses.

16. (SBU) Butkevicius detailed plans to be made in conjunction with the Ministry of Social Security and Labor (MSSL) to increase the threshold at which employer contributions to SODRA - Lithuania's retirement and health social insurance system - are required to be paid. The Ministry of Finance's tax inspectors, who collect the SODRA taxes on behalf of the MSSL, would also work with the Department of Statistics on this issue. However, Butkevicius added that his ministry has trouble training the tax inspectors. Butkevicius also cited Lithuania's large shadow economy as a target of his attention. He expressed his hope to address this vast pool of unreported income and uncollected tax and customs fees by prohibiting the sale of imported goods at Lithuania's enormous Garuniai open-air market.

Lithuania's Continued Economic Growth

17. (U) Lithuania's growth in GDP for 2004 was 6.6%. Butkevicius noted that the 2003 GDP growth figure of 9.9% was unsustainable and reflected a boom in real estate in construction; the 2004 figure more properly reflected the economy's long-term growth potential. He noted another sign of the sustainability of this growth rate was the increase in Lithuania's exports to European Union (EU) countries, which in 2004 increased from previous years. (The media reported on February 10 that Nord LB adjusted down its forecast of Lithuania's 2005 GDP from 6.6% to 5.9%.)

Bi-lateral Issues

18. (SBU) Ambassador Mull asked about a variety of bilateral issues focusing on taxation, many of which had been mentioned in the Ambassador's last discussion with Butkevicius in June 2004 (ref b). Chief among these was Lithuania's application of VAT to USG assistance and Fulbright Scholars' stipends. Such taxation had led to the cancellation of planned anti-fraud training in 2004, and endangered a potential Science and Technology Agreement between the U.S. and Lithuania. Butkevicius indicated that the Embassy should shortly receive formal notice from the Government on the resolution of this problem. He also said he would resolve the issue of taxation of Fulbright stipends.

19. (SBU) Ambassador Mull raised three other issues regarding taxes: inconsistencies in returning VAT refunds to U.S. diplomats; the tax inspectorate's attempt to have the U.S. Embassy register with the tax inspectorate for the purpose of collecting SODRA for locally engaged staff; and the tax inspectorate's continuing insistence that the Embassy pay a tax on trucks - thus preventing the Embassy from properly registering its trucks.

110. (SBU) Regarding VAT refunds, Butkevicius noted that other diplomatic missions had also complained about this matter. He suggested that the missions draft a joint letter to the MFA, which would initiate a process to resolve the matter. Butkevicius said that he will talk to the MSSL to resolve the SODRA problem. As to the truck tax, Butkevicius says that a decision has already been reached, and that he will shortly inform the Embassy of that decision in writing.

Comment: Fiscally Responsible - but not Flexible?

111. (C) Butkevicius was friendly and cooperative throughout the meeting, and seemed eager to resolve our bilateral issues. He came across as a responsible fiscal disciplinarian; it is not surprising that he is unwilling to consider tax reductions as incentives to attract FDI to stimulate growth, since he sees his principal task as keeping the tax revenues flowing. He does, however, seem pragmatic enough to review our various taxation problems with the GOL.
MULL